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SUBJECT: ABU DHABI "BAILS OUT" DUBAI VIA UAE CENTRAL BANK

1. This is a joint Embassy Abu Dhabi - Consulate general Dubai cable.

2. (C) Summary. The Dubai government announced on February 22 that it would float a USD 20 billion bond to support its debt repayment schedule and that the UAE Central Bank will subscribe to half of the five year bond, which will pay a four percent dividend. The public announcement seeks to alleviate immediate fears about Dubai's insolvency and puts an end to months-long speculation about if, when and how wealthier Abu Dhabi would support its flashier and indebted brother. Despite the injection, Dubai's financial health remains questionable in the medium-term. UAEG officials say widespread rumors that Dubai would be allowed to collapse did not reflect the importance of mutual political and economic integration. End Summary.

3. (C) The Dubai Department of Finance announced on February 22 that the UAE Central Bank had subscribed to half of a USD 20 billion long-term bond to cover a portion of public sector debt estimated at USD 80 billion, but rumored to be as high as USD 150 billion. The five year unsecured fixed rate paper will yield four percent annually and is likely to support Dubai's efforts to meet its short-term debt obligations, including an estimated USD 12 billion of debt maturing in 2009.

4. (C) The announcement comes on the heels of a February 21 restructuring of Bourse Dubai debt. Dubai refinanced the USD 3.8 billion obligation by injecting additional equity (about USD 1 billion), agreeing to new terms with the original lending syndicate, and tapping additional UAE-based banks. The UAE banks that took on fresh exposure, already stretched by high loan-to-deposit ratios, are rumored to have received government cash injections to ensure a successful closing (nfi). The restructured loan priced at 350 basis points over LIBOR, an unusually reasonable figure considering Dubai credit default swap (CDS) spreads were exceeding 1000 basis points. The two deals demonstrate the complex and opaque dance taking place between Dubai and Abu Dhabi, but indicate a shared commitment to avoid worst case scenarios. Time will tell if the bailout brings a degree of investor confidence back to Dubai, or simply slows the bleeding temporarily.

5. (S) Dr. Omar Bin Sulaiman, Vice Chairman of the UAE Central Bank and Governor of the Dubai International Financial Centre, told the Consul General on February 23 that he had orchestrated the much needed federal bailout, after a "rough" period of relations between Dubai and Abu Dhabi. Bin Sulaiman said the Central Bank's involvement was a very intentional confidence building signal. According to Abu Dhabi insiders, Dubai resisted any public acknowledgement of federal and/or Abu Dhabi aid to the troubled city-state, a condition set by Abu Dhabi's ruling Al Nahyans. Bin Sulaiman said the second USD 10 billion tranche would be offered to banks and institutional investors, and that several large US banks had already expressed interest. (Comment: The widespread on Dubai CDS makes this unlikely at acceptable interest rates. End Comment.)

COMMENT

6. (C) The unsecured bond fundamentally does little to improve Dubai's overall financial outlook and transparency. (Note: Emirati

officials report ongoing high-level debate about how much financial transparency is needed to respond to weak investor sentiment. End Note.) It is unclear how the Dubai government (and/or "Dubai Inc.") will utilize the USD 10 billion injection, as debt obligations and payment schedules remain opaque. Dubai Inc. is clearly under pressure to review its operations to find every cent of cash; project cancellations and redundancies have given way to consolidations. Rumors abound that Dubai entities may be forced to sell off foreign assets, even at a significant loss, in order to support current obligations. Without a significant improvement in emerging market risk appetite by international credit markets, Dubai will likely face the same situation in 12 months time, if not possibly sooner.

17. (C) For now, the announcement stems rampant speculation about how and when Abu Dhabi would bail out Dubai (reftel). Although the wealthier Abu Dhabi approved this highly risky commitment of UAE Central Bank reserve assets, the price demanded of Dubai was public recognition of its dependence on the UAE federal government, and thereby the resources of Abu Dhabi. The federal cover allows Abu Dhabi to project the political-economic balance of power between the two emirates without overreaching or appearing opportunistic. The initial bailout highlights that the cohesion of the UAE federation, economic integration, and their mutual financial integrity trump the ongoing rivalry between the two emirates. Abu Dhabi's involvement is not without a degree of self-interest, as Abu Dhabi investors and businesses are heavily exposed to Dubai and a failed Dubai would likely drag down Abu Dhabi's own ability to borrow. End Comment.

OLSON